GARRIGUES

Formal launch of China (Shanghai) Pilot Free Trade Zone

Following the State Council's passage of *Overall Plan for China (Shanghai) Pilot Free Trade Zone* (the "Overall Plan") on July 3rd, 2013 and the subsequent approval of the establishment of China (Shanghai) Pilot Free Trade Zone (the "PFTZ")[1] on August 22nd, 2013, the PFTZ was formally launched on September 29th, 2013. The Overall Plan and supporting rules are now available to the general public and we hereby summarize them as guidance to the PFTZ.

OVERVIEW

Acting as the test-bed for China's economic reform policies, the PFTZ is aimed to (i) boost government function transformation, (ii) expand service sectors and reform foreign investment administration system, (iii) develop headquarter economy and new trading model, (iv) enhance capital account convertibility and fully open up the financial service, (v) establish a classified regulatory model of goods, (vi) create a policy framework to support investment, and (vii) create an innovative international business environment that is subject to the rule of law.

Depending on the result of two to three years' implementation, the pilot policies carried out in the PFTZ may gradually be applied to the whole country.

MAIN MEASURES

The main measures to be taken in the PFTZ cover (i) administrative measures, (ii) further opening-up of service sectors, (iii) taxation, (iv) financial reform and (v) trading.

1. Administrative Measures

- Foreign Investment

For foreign investment practice in China, *Industrial Guidance Catalogue for Foreign Investment (Revised in 2011)* (the "Catalogue 2011") provides restrictions and prohibitions on foreign investment in some sectors and administrative approvals are prerequisite for foreign investment in China. However, *Special Administrative Measures of Entry of Foreign Investment within China (Shanghai) Pilot Free Trade Zone* (the "Negative List") is adopted in PFTZ, which specifies sectors that are restricted or prohibited to foreign investors and outside of which national treatment is granted. According to our observation, the Negative List is almost identical to Catalogue 2011 and even provides stricter restriction, for instance, Internet data center service, which is restricted to foreign investment under Catalogue 2011, is now prohibited in the PFTZ.

The process for foreign investment is simplified by adopting filing requirement as the principle, while administrative approvals are still applied in some circumstances as an exception: (i) in the event of investment in sectors outside of the Negative List, filing process will be applied unless approvals are otherwise required by other laws and regulations; (ii) in the event of investment in sectors within the Negative List, approvals by National

[1] The PFTZ covers the Waigaoqiao Bonded Zone, the Waigaoqiao Logistics Park, the Pudong Airport Integrated Bonded Zone and the Yangshan Free Trade Port Area.

Development and Reform Commission (the "NDRC") or its local counterpart is required for foreign-invested projects and approvals by Ministry of Commerce (the "MOFCOM") or its local counterpart for foreign-invested enterprise.

- Outbound Investment

Outbound investment benefits from the PFTZ as well. Filling process is also adopted for overseas investment projects and overseas enterprises generally, except in certain circumstances where NDRC's approvals are still required for overseas investment projects and MOFCOM's approvals for overseas enterprise.

- Commercial Registration

There are significant changes in commercial registration, where subscribed capital approach is currently adopted. In contrast with the original paid-in capital approach, no requirements are imposed on the minimum amount, payment schedule and method of registered capital when setting up companies in the PFTZ. In addition, annual inspection is now replaced with publication of annual report.

2. Further Opening Up of Service Sectors

6 sectors and 18 industries are announced to be further opened up in the PFTZ and we summarize the key changes as follows:

- Financial Service

- Allow qualified foreign financial institutions to set up wholly foreign-owned banks;
- Allow to set up foreign-invested specialized health and medical insurance institutions[2];
- Remove requirement on minimum registered capital for establishment of single-aircraft or single-ship subsidiaries of financial leasing companies; and
- Allow financial leasing companies to concurrently offer commercial factoring business related to their primary business.

- Shipping Service

- Allow foreign investors to establish Sino-foreign equity joint venture or Sino-foreign cooperative joint venture to conduct international shipping business with more than 49% equity interest; however, the joint venture shall still be controlled by Chinese investors[3];
- Allow foreign ships owned or controlled by Chinese-invested companies to pilot the coastal shipping business of foreign trade import and export containers between domestic coastal ports and Shanghai Ports; and
- Allow to set up wholly foreign-owned international ship management enterprises in addition to Sino-foreign equity joint venture and Sino-foreign cooperative joint venture enterprises.

- Commercial and Trading Service

[2] The equity ratio held by foreign investors in life-insurance companies shall not exceed 50%; the term "specialized health and medical insurance" needs to be further defined by competent authorities.
[3] Upcoming laws and regulations are expected to address whether such control requirement will be removed.

- Allow foreign investors to set up application store with moth than 50% equity interest[4];
- Allow foreign investors to invest in for-profit e-commerce with more than 55% equity interest[5]; and
- Allow foreign-invested enterprises to manufacture game console and entertainment machine within the PFTZ and, subject to content review, to sell such them within China.

- Professional Service

- Increase the maximum equity ratio held by foreign investors[6] in Sino-foreign equity joint venture talent intermediary institutions from 49% to 70%;
- Decrease the minimum registered capital of Sino-foreign equity joint venture talent intermediary institutions from USD 3 million to USD 1.25 million[7]; and
- Allow to establish foreign-invested investing companies in form of joint stock limited company[8].

- Cultural Service

- Remove equity ratio restriction on foreign investors of foreign-invested performing show agencies and allow wholly foreign-owned performing show agencies to be established to provide services in Shanghai; and
- Allow to establish wholly foreign-owned entertainment venues within the PFTZ.

- Social Service

- Allow Sino-foreign cooperative joint venture educational training institutions to conduct business activities for profit;
- Allow Sino-foreign cooperative joint venture vocational skills training institutions to conduct business activities for profit; and
- Allow foreign investors[9] to establish wholly foreign-owned medical institutions.

3. Taxation

Certain types of investment-related capital gains, stock-based incentive compensation and trade-related levies are granted with tax treatment in the PFTZ, However, the concrete details have not been released by the relevant authorities.

4. Financial Reform

[4] It needs be confirmed with competent authorities whether wholly foreign-owned enterprise can be established.
[5] The term “for-profit e-commerce” needs to be further defined by competent authorities.
[6] Hong Kong and Macau services providers are not imposed with equity ratio restriction and allowed to establish wholly-owned talent intermediary agencies in China.
[7] It needs to be further confirmed with AIC whether subscribed capital approach is applicable or not.
[8] The requirement on Chinese investors of Sino-foreign joint venture investing companies is not mentioned in the Negative List, thus it needs to be further confirmed with Shanghai MOC whether such requirement is still imposed.
[9] Hong Kong, Macau and Taiwan service providers are allowed to establish wholly foreign-owned medical institutions in Shanghai, Chongqing, Guangdong, Fujian and Hainan as well as all the municipalities directly under the central government and provincial capitals in China.

The Overall Plan indorses financial reform and financial innovation. It asserts to promote convertibility of RMB capital accounts, liberalization of financial interest and cross-border use of RMB to the extent of manageable risks, to encourage establishment of foreign-funded banks or Sino-foreign joint venture banks, to allow foreign enterprises to gradually participate in commodity futures transactions, and to reform foreign debt administration.

5. Trading

The PFTZ is aimed to transform and upgrade the trading model with its excellent geographical advantages. The Overall Plan supports the development of offshore business, international and domestic trading, and cross-border e-commerce services. Headquarters of multinational companies and centers of integrating operation and trade settlement are also encouraged to be set up in the PFTZ